

China: June PMIs indicate an stronger-than-expected growth momentum

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China's official manufacturing PMI (released by NBS last Friday) picked up significantly to 51.7 in June from 51.2 in May, well above market expectations (Consensus: 51). Following the same trend, the Caixin China Manufacturing PMI announced today, which includes a survey sample tilting toward SMEs and exporters, increased to 50.4 in June from 49.6 in the previous month (Consensus: 49.8). (Figure 1) The soaring NBS and Caixin PMI outturns were mainly driven by surging external demand and the easing of credit condition in June (see our [Economic Watch: Financial deleveraging: two steps forward; one step back](#)). Now it is increasingly likely for the authorities to meet their full-year growth target of 6.5%.

Nevertheless, the economy is still subject to a number of uncertainties externally and domestically. Moreover, the stronger-than-expected momentum could embolden the authorities to push forward with greater efforts its deleveraging campaigns in both financial sector and over-capacity industries. That being said, the authorities will continue its prudent stance of monetary policy and deploy more measures to crack down rampant shadow banking activities and debt overhang. We therefore believe that China's secular slowdown will continue over the next couple of years if the pace of structural reforms in certain key areas remains anemic.

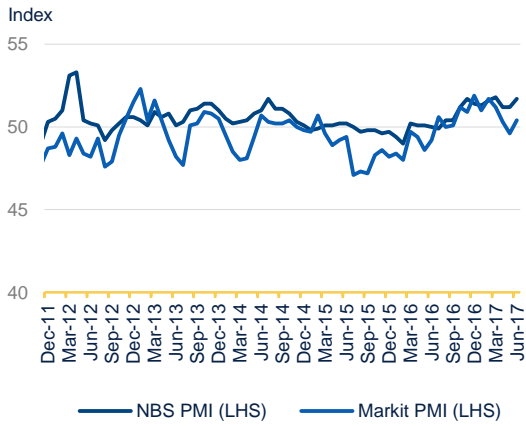
Broad-based increases in NBS PMI sub-categories:

On the demand side, new order index significantly increased to 53.1 from 52.3 previously, as manufacturing industry expanded and internal demand gain its momentum. New export order index and import index also picked up (52 and 51.2 respectively), indicating external demand helps to sustain growth. On the supply side, production index increased to 54.4 from last month's reading of 53.4 while the finished goods inventory index declined, indicating manufacturing production continued to expand; in addition, the business activity expectation index also surged to 58.7 from 56.8, suggesting a positive market sentiment. (Figure 2) On a different note, larger enterprises seemed to outperform small-and-medium-sized ones (SMEs) in June, indicating that SMEs are more vulnerable to the credit tightening associated with the authorities' stepped-up efforts to curb shadow banking activities.

More policy room for tightening measures on shadow banking and debt overhang:

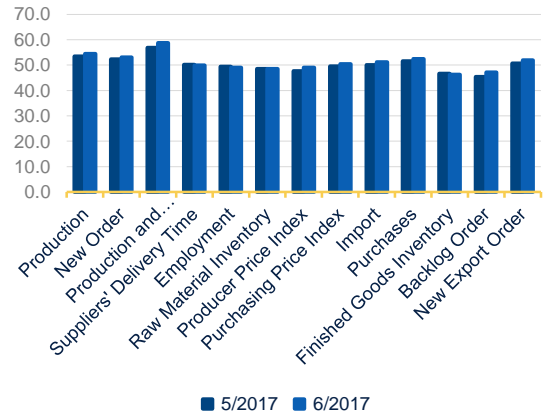
The upbeat PMIs reflected the better-than-expectation momentum of China's economy. To a certain degree, it could reinforce the government's confidence of pursuing stricter regulations to correct the existing financial vulnerabilities, such as debt overhang, shadow banking and housing bubbles, which grew rapidly with the previous implementation of distortionary growth-stimulating policy initiatives. The deleveraging measures, both in the financial and real sector, will consequentially drag the growth over the medium term.

Figure 1. Both NBS and Caixin PMI picked up strongly



Source: BBVA Research, CEIC

Figure 2. The increasing of NBS PMI outturns are broad-based



Source: BBVA Research, CEIC

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